Reduce Dairy Price Support Outlays. The federal government supports the price of milk by purchasing manufactured dairy products. The dairy price support program has increased farm milk prices at the expense of consumers and taxpayers, but it has also helped to stabilize the dairy industry, resulting in an assured supply of milk and dairy products. In the past two years, however, high milk price supports have contributed to a sharp expansion in milk production. In 1981, the commercial milk supply exceeded commercial use by about 10 percent, and the federal government purchased the excess at a cost of almost $2 billion. The government inventory of cheese, butter, and nonfat dry milk is nearly three times as large as commercial stocks.

Under the Agriculture and Food Act of 1981, the Secretary of Agriculture must increase the level of milk price support at the beginning of each marketing year (October 1) for the 1982 through 1984 marketing years. The act sets a minimum level of $13.25, $14.00, and $14.60 per hundredweight of milk, respectively, for each of these marketing years; these levels are slightly less than 70 percent of parity. Under certain conditions, the minimum level of support rises to 70 or 75 percent of parity.

Clearly, there is a serious imbalance between milk supply and demand. Furthermore, it is unlikely that a balance will soon be restored. Consumption cannot be expected to increase by much more than 1-2 percent annually over the long term. On the other hand, milk production is projected to increase, so that there is little prospect of commercial milk supply coming in line with consumption by 1986. Government purchases are expected to remain high relative to milk production, exceeding those needed to provide reasonable stability in prices and supplies. Therefore, dairy price support outlays are projected to average $1.8 billion during the next several years.

The Congress could act to reduce dairy price support outlays and restore milk supply and demand balance. To achieve this objective, the Congress could enact legislation that would reduce the current level of milk price support by 15 percent over four six-month intervals beginning April 1, 1982 (see Appendix A-350-b).

A phased reduction in the level of milk price support would be a clear signal to dairy farmers that the federal government intended to restore supply and demand balance to the industry. This approach would allow an orderly adjustment process and perhaps avoid a more disruptive adjustment in the future. On the one hand

it would act to reduce milk prices and milk production, and on the other it would promote increased consumption of milk and dairy products. Annual average milk production in 1983-1985 would decline from the level under current policy by 5 percent. Consumer prices would average 8 percent lower, and consumption would average 1 percent more per year. With reduced production and increased consumption, government purchases could decline. Consequently, dairy price support outlays would average $1.3 billion less per year in 1983-1985.

While a reduction in the level of milk price support would reduce dairy price support program outlays, dairy farmers' annual average cash receipts in 1983-1985 would decline about 20 percent from the level under current policy. Some dairy farmers would be hard pressed to stay in operation because of lower incomes. This option might lead to more volatile supplies and prices, since milk supply and commercial demand would be in close balance by 1986; there is evidence of greater price volatility when government purchases are less than 2 percent of annual milk production. Therefore, the Congress could eventually reassess the level of price support relative to expected milk production and purchases.

Strengthen the Role of the Market for Export Crops. Farmers producing major export crops--grains, upland cotton, and soybeans --face even more than the normal uncertainty because of international market conditions. The nation has an interest in reducing uncertainty for these farmers while at the same time strengthening their orientation toward the market. A reduction of uncertainty stimulates farmers to invest in cost-reducing technology, since they can feel more assured of a return on their investment. The following options would be consistent with recent national policy. One option would eliminate deficiency payments to farmers that supplement their incomes in years when crop prices are low. Another option would provide a program of revenue insurance.

Eliminating deficiency payments could save up to $4 billion annually without detriment to domestic agriculture (see Appendix A-350-c). The Congress authorized these payments in the mid-1970s for wheat, feed grain, upland cotton, and rice to smooth the transition toward fuller participation in the world market. They are based on differences between target prices and market prices.

Over the crop years 1974-1980, deficiency payments totaled about $2.5 billion. In 1981 alone, however, they amounted to about $1 billion because of higher target prices, low crop prices, and increased participation by farmers in commodity programs. The

payments were highly concentrated among larger farmers, and were of small consequence to others.

The Agriculture and Food Act of 1981 continues deficiency payments for the 1982-1985 crop years. While CBO's baseline projection includes no deficiency payments for most of that period, it estimates that low farm prices near loan rates could trigger payments of up to $4 billion yearly.

Given the evolution of agricultural policy, deficiency payments have largely fulfilled their function. Farmers have demonstrated a willingness and ability to supply food and fiber at prevailing world market prices, so that deficiency payments could now be eliminated without detriment to domestic agriculture. Other provisions of existing commodity programs--the farmer-owned reserve, crop loans, and acreage diversion payments--could be used, if needed, to prevent large drops in crop farmers' incomes. One drawback is that these provisions might not, by themselves, offer farmers sufficient incentive to take land out of use during periods of surplus production. An attraction of deficiency payments has been that they provided farmers the incentive to participate in cropland set-aside programs, thereby helping to stabilize prices and output.

A voluntary revenue insurance program could be designed to provide individual farmers protection against the hazards of variable export demand, erratic foreign exchange rates, or export embargoes, and also against crop production losses. It could be used in place of traditional commodity programs and emergency disaster loans.

A revenue insurance program could be an extension and expansion of the federal crop insurance program administered by the Federal Crop Insurance Corporation (FCIC). Federal crop insurance is all-risk (natural hazard) insurance. It guarantees a farmer that poor yields will not reduce revenue per acre below 75 percent of expected revenue based on normal yield and a selected price. Lower levels of protection can be selected, and premiums--30 percent subsidized--vary directly with the level of yield guarantee and price selection. Insurance companies and independent agents market federal crop insurance, and some companies participate in reinsurance schemes with the FCIC and share in the profits or losses. The revenue insurance program could be similarly operated.

Federal crop insurance provides protection against revenue losses arising from changes in output. A revenue insurance program would add protection against changes in market prices. Revenue insurance would guarantee a farmer that his revenue per acre for a specific crop would not fall below its normal range. For example, if a farm's annual revenue per acre of corn normally fluctuates within a range of plus or minus 25 percent, the government might insure that the farmer's revenue would not fall below that range, thereby requiring the farmer to bear the risk of "normal" revenue variability. The midpoint of the range would be determined on the basis of the farm's average yield and recent average prices. Premiums would reflect the level of revenue guaranteed.

In effect, revenue insurance would assure participating farmers a minimum level of revenue per acre regardless of production or price variability. Furthermore, with this type of revenue protection, the government would not have to use traditional commodity program mechanisms to support and stabilize prices and incomes.

Eventually, farmers might bear all the costs of a revenue insurance program. Compared with the projected costs of commodity programs and emergency disaster loans, the net budget savings would then be about $3.0 billion. Initially, however, premiums could be partly subsidized to encourage participation. With subsidies, the peak annual costs of a revenue insurance program might be $2 billion.

Revenue insurance would reduce income variability for farmers, and would tend to encourage production, but farm prices would likely fluctuate more widely in the absence of stabilizing mechanisms such as commodity loans and the farmer-owned grainreserve. Since relatively stable supplies and prices are of importance to consumers, a domestic reserve, particularly for grains, might be needed. A government-owned grain reserve could be established, with the government purchasing grains in the open market and releasing them under prescribed rules. A grain reserve equal to 15 percent of average U.S. grain exports would cost $2 billion to establish and entail annual carrying costs of $400 million.

Shifting Some Expenditures to States or Local Governments or to Private Groups

Two federal agriculture programs could be financed through other channels.

Reduce Federal Support of Extension Education. Extension education activities help people identify and solve their farm, home, and community problems through the use of research findings of the Department of Agriculture and state land grant colleges. State and county extension work is financed from federal, state, county, and local sources. Federal funds--which account for about 40 percent of overall extension financing--are mainly distributed to the states by prescribed formula. In 1981, the federal share was about $300 million.

Extension education programs once provided farmers much of their information about new production technology and ways to improve family living. Today's farm families are far better educated, more fully integrated into the nonfarm economy, and obtain information from a wider range of sources. For the most part, extension activities today are oriented toward improving the quality of life for rural and urban citizens.

The level of federal support of extension education activities might be reduced without detriment to the nation's long-term supplies of agricultural products. A 25 percent reduction in formula funds to states would save about $60 million annually and reduce total extension funding by about 7 percent. The reduction in federal funds would mean that state, county, and local governments would have to increase their share of extension education costs or else reduce the level of such activities (see Appendix A-350-f).

Terminate Federal Funding of Foreign Market Development. The federal government provides funding for overseas market development projects of cooperators (nonprofit commodity groups), regional groups representing 44 state departments of agriculture, and private firms. It also supports cooperator offices overseas that conduct promotion activities. In 1980, the federal government spent $20 million supporting foreign market development activities; about twice that amount was spent by cooperators in this country and abroad.

The program is based on the premise that developing foreign markets is too costly and risky for private groups. But there is little indication that federal financing has been critical to increasing exports. Furthermore, there is a tendency for cooperators to rely on federal funds long after they have become established and experienced in foreign market development. Since new cooperators are continually seeking and receiving federal assistance, federal outlays increase annually.

The federal government could discontinue its cost-sharing of overseas market development, thereby saving approximately $145 million in 1983-1987 (see Appendix A-350-g). In the absence of federal funds, private groups would have to assess the costs and benefits of their projects and decide whether to increase their contributions or reduce the scale of activity. Even though the federal government stopped giving direct financial support to these groups, its market development specialists could continue to provide technical assistance.

CONCLUDING COMMENTS

Real outlays for agriculture have been declining, and now account for about 1 percent of total federal outlays. Some further reductions in agricultural outlays could be made by shifting the financing of certain programs to state and local governments or to the private sector. Considerably larger budget reductions could be made through changes in commodity programs, which account for two-thirds of agriculture outlays. The trend of the last two decades has been to reduce the federal role in the production and marketing of farm commodities and to increase the role of market forces. The continuation of this policy, particularly for dairy farmers, offers the greatest potential for future budget reductions.

CHAPTER VII. TRANSPORTATION, COMMERCE AND HOUSING CREDIT, AND COMMUNITY AND REGIONAL DEVELOPMENT

The budget functions encompassing transportation (400), commerce and housing credit (370), and community and regional development (450) cover a wide range of activities designed to foster economic growth and development. (For brevity, this chapter refers to programs funded under these functions as transportation and development activities.) Federal support for transportation provides funds to plan, build, maintain, and operate mass transit systems, highways, railroad service, airports and airways, and ocean shipping. 1/ Programs under the commerce and housing credit function promote employment and commerce and ensure the availability of credit for various housing and business undertakings. These programs include direct and guaranteed housing loans; mortgage purchase, guarantee, and insurance activities; loans and loan guarantees to private businesses; and various other business assistance efforts. The community and regional development programs support local economic development efforts by offering grants, loans, loan guarantees, and technical assistance to states and localities; this support is designated for public works, community facilities, and economic development and revitalization projects.

BUDGET HISTORY AND PROJECTIONS

Over the last decade, total budget outlays for transportation and development programs increased at an average annual rate of about 11 percent to an aggregate level of about $37 billion in fiscal year 1981. Transportation accounted for more than half of these expenditures--about $23.3 billion. Community and regional development accounted for about $9.4 billion, and commerce and

1. Expenditures by the U.S. Army Corps of Engineers for inland waterways and deep-draft navigation--included in budget function 300--are also discussed in this chapter as part of the transportation program area. Expenditure totals and tables in this chapter do not, however, include these expenditures by the Corps. Instead, all Corps expenditures are included in the tables and expenditures totals contained in Chapter V.

housing credit for the remaining $4 billion. The baseline projections for transportation and development reflect a slower growth rate than in the past, with total spending falling to an average annual rate of about 3 percent over the next five years.

Historical Trends, 1970-1981

Transportation and development programs have accounted for a relatively stable share of total federal expenditures over the last decade: somewhat less than 6 percent. Federal outlays in these categories more than tripled during this period, from $11.5 billion in 1970 to almost $37 billion in 1981--about the same rate of increase as occurred in total federal outlays. Federal expenditures in each of the three budget functions grew at different rates, however. While transportation outlays more than tripled between 1970 and 1981 and community and regional development outlays increased by almost four times, outlays for commerce and housing credit did not quite double. Federal expenditures for transportation and development thus shifted away from commerce and housing credit activities to transportation and community and regional development programs.

The allocation of federal expenditures for transportation and development also shifted within the separate budget functions and program areas (see Table VII-1). The emphasis of transportation expenditures shifted away from highways (and to a lesser extent, from air and maritime activities) to mass transit and railroads. Highway funding accounted for 65 percent of total transportation expenditures in 1970 but fell to only 40 percent in 1981. At the same time, expenditures for mass transit and railroads climbed from less than 2 percent of total transportation expenditures in 1970 to 33 percent in 1981.

Similarly, federal outlays for commerce and housing credit shifted away from subsidies for postal service and other direct expenditure programs to mortgage credit programs. Federal expenditures for mail service declined in absolute terms, from $1.5 billion in 1970 to $1.3 billion in 1981, while federal outlays for housing credit grew to more than $2.0 billion in 1981--a significant increase from 1970, when these activities accounted for slightly less than $600 million in federal outlays.

Federal outlays for community and regional development have also shifted in emphasis over the last decade--away from community development efforts to area and regional development and disaster

TABLE VII-1. FEDERAL OUTLAYS FOR TRANSPORTATION, COMMERCE AND HOUSING CREDIT, AND COMMUNITY AND REGIONAL DEVELOPMENT (In billions of dollars)

Programs	Actual 1970	Actual 1981	Estimated 1982	Baseline Projection 1983	Baseline Projection 1987
Transportation					
Highways	4.56	9.48	8.73	8.75	11.42
Mass Transit	0.11	3.92	3.94	4.22	4.67
Railroads	0.02	3.70	2.07	1.25	1.41
Air	1.42	3.78	3.60	3.68	4.01
Maritime	0.91	2.42	2.64	2.74	3.30
Other	0.02	0.01	0.22[a]/	0.24	0.25
Pay Raises b/	---	---	---	0.26	1.49
Subtotal	7.04	23.31	21.20	21.14	26.55
Commerce and Housing Credit					
Housing Credit c/	0.59	2.05	3.04	2.32	5.34
Banking and Finance	-0.50	-1.36	-1.12	-1.57	-2.37
Postal Service	1.51	1.34	0.83	0.81	0.80
Small Business Assistance	0.15	0.81	0.74	0.71	0.77
Other	0.35	1.16	1.12	1.07	1.13
Pay Raises b/	---	---	---	0.06	0.37
Subtotal	2.11	4.01	4.62	3.41	6.04
Community and Regional Development					
Community	1.45	5.00	5.07	4.72	5.29
Area and Regional	0.69	2.71	2.77	2.22	2.32
Disaster Assistance	0.25	1.71	1.05	1.05	1.43
Pay Raises b/	---	---	---	0.05	0.30
Subtotal	2.39	9.42	8.90	8.04	9.34
Total	11.54	36.74	34.71	32.59	41.93

NOTES: Details may not add to subtotals or totals because of rounding. Minus sign denotes receipts in excess of outlays.

a. Includes pay supplementals and offsetting receipts

b. See Table IV-1, footnote a, for distribution of pay raises.

c. Housing credit was classified as part of the community and regional development budget function in 1970 but is currently classified as part of the commerce budget function.

assistance programs. Between 1970 and 1981, outlays for community development fell from 61 percent to 53 percent of total outlays in this category. At the same time, spending for area and regional development and disaster assistance rose at a faster rate than total federal expenditures--area and regional development expenditures increased almost four-fold and disaster assistance almost seven-fold.

To some extent, these expenditure shifts reflect geographic changes in population and economic activity, combined with continued growth in per capita income. For example, regional shifts in economic activity from the older, industrialized areas of the Northeast and Midwest (the frostbelt) to the Southwest (the sunbelt) contributed to the decline of several large freight railroads, including the Penn Central, Rock Island, and Milwaukee railroads. In 1976, the bankruptcy of the Penn Central culminated in the consolidation of seven eastern railroads into the Consolidated Rail Corporation (Conrail); since its creation, Conrail has required more than $5.5 billion in federal aid. Similarly, the financial collapse of the Rock Island and Milwaukee railroads has resulted in additional subsidies. Consequently, total federal aid to railroads grew from $17 million in 1970 to practically $4 billion in 1982. 2/

Similarly, the continuing suburbanization of population and economic activity, combined with growing per capita income, stimulated the use of passenger cars and a concurrent decline in mass transit. The rise in federal support for urban highways reflected the changing transportation needs of this increasingly suburbanized population. At the same time, however, government at all levels attempted to divert this shift away from public transit by subsidizing fares to keep them low and by extending service areas. Such efforts have greatly enlarged the deficits associated with transit operations. As a result, federal aid for transit grew from 1.6 percent of federal transportation expenditures in 1970 to almost 17 percent in 1981. Similarly, the increased funding for rural development, which rose by nearly 300 percent between 1970 and 1981, also partly reflected federal efforts to dampen the adverse economic effects of population migrations--in this case, from rural to metropolitan areas.

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2. The 1981 outlay total for railroads is distorted by $2.13 billion paid in settlement of the Conrail property dispute. The 1982 outlay estimate includes another $0.55 billion for the same purpose, which should complete the settlement.

One general trend in federal expenditures that emerged over the 1970-1981 decade is a shift away from federal support of public-sector activities to private business endeavors. Throughout the 1960s and early 1970s, federal programs were aimed primarily at augmenting public-sector capacity to deal with economic development problems. In the last few years, however, the overall thrust in federal policy has gone much farther toward aiding the business sector as a means of promoting revitalization in distressed or lagging areas. An example is the Urban Development Action Grants program, established in 1977 under the U.S. Department of Housing and Urban Development to create new jobs by assisting businesses in distressed areas. Moreover, recent changes in the Community Development Block Grant program may somewhat shift its emphasis away from public-sector activities and toward business development. This same trend is also reflected by increases in direct business assistance programs (in particular, disaster relief and small business assistance) and aid to specific private and quasi-private corporations--notably Amtrak, Chrysler, Conrail, and Lockheed.

The 1982 Budget Decisions

In the 1981 reconciliation act and in appropriations actions for 1982, the Congress made significant reductions in funding for all the transportation and development functions. Total 1982 budget authority for these functions is 15 percent below the 1981 level, and 1982 appropriations to date are 21 percent below the 1981 appropriated levels.

Transportation. Sizable reductions have been made in transportation programs. Funding for urban mass transit has been cut from $4.7 billion in 1981 to $3.5 billion in 1982, with most of the reductions affecting capital grants. Budget authority for the federal-aid highway program is $8.3 billion in 1982 (down from $9.1 billion in 1981), and the ceiling on federal-aid highway obligations has been lowered from $8.75 billion in 1981 to $8.0 billion in 1982. Other large reductions have been made in funding for Federal Aviation Administration operations (down $245 million) and facilities and equipment purchases (down $90 million), as well as for the Maritime Administration's ship construction program (down $135 million).

Appropriations for Amtrak have also been cut, from $881 million in 1981 to $735 million in 1982. Nevertheless, because the reconciliation act allowed Amtrak to forego interest payments

on its federal debt and made other changes that will decrease costs, Amtrak will be able to provide approximately the same level of service in 1982 that was offered in 1981; however, its capital acquisition program will be reduced. Similarly, payments to Conrail have been reduced, from $400 million in 1981 to $85 million in 1982. In addition, the reconciliation act modified labor protection provisions, established a program for reducing the number of Conrail employees, and set a schedule for the sale of Conrail to the private sector if profitability goals are not met--all intended to reduce long-term federal costs in this area.

Commerce and Housing Credit. The U.S. Postal Service (USPS) requested an appropriation for 1982 of $1.5 billion to compensate for Congressionally mandated service levels, reduced revenues from certain classes of mailers, and other expenses incurred by the former Post Office Department. In his March budget request, President Reagan proposed a payment of $869 million to the USPS, a reduction of more than 40 percent. Although a ceiling of $946 million was established in the reconciliation act, the continuing resolution provides appropriations of only $834 million for 1982.

Reductions in small business loans were also made in 1982. In his March 1981 budget request, President Reagan recommended approximately $260 million in direct loans and $3.15 billion in guaranteed loans to small businesses. These program levels were some 30 to 40 percent lower than 1981 levels. As provided in the continuing resolution, guaranteed loans will be $3.3 billion and direct loan levels will be further reduced to $225 million. Smaller reductions have also been made in other small business activities and administration.

Community and Regional Development. The reconciliation act eliminated two small community development programs--comprehensive planning grants and the neighborhood self-help development program--and reduced funding for larger community development programs. The Community Development Block Grant program was cut 6 percent and the Urban Development Action Grant program was reduced 35 percent. The rehabilitation loan fund received no new monies, but it was allowed to continue making loans with loan repayments. Reconciliation also set authorization ceilings that will reduce possible future funding levels for community development programs. In total, 1982 appropriations for community development programs fell 11 percent below 1981 levels.

Appropriations for fiscal year 1982 for area and regional development programs totaled $1.9 billion, $1.5 billion below the

level that CBO estimates indicate would be needed in 1982 to maintain those programs at initial 1981 levels. That appropriation level reflects the adoption of many of the reforms and funding reductions submitted by the Administration in March 1981, although the Congress provided more funding than the Administration requested for some programs. The Congress retained, for instance, the basic functions of both the Appalachian Regional Commission and the Economic Development Administration at reduced funding levels, whereas the President had requested their elimination.

Disaster assistance programs were untouched by the reconciliation act, with the notable exception of the Small Business Administration's Disaster Loan Program. In 1981, the Congress significantly altered this program by narrowing eligibility requirements and modifying loan terms; both these measures are expected to reduce loan demand and the net federal cost for disaster loan assistance.

Baseline Projections, 1983-1987

Growth in federal outlays for transportation and development is projected to slow in the near future as a result of the 1982 budget decisions. Baseline outlays for these functional areas are projected to increase by $7.22 billion (or 21 percent) by 1987. Transportation outlays account for most of this growth--about $5.35 billion by 1987. Nevertheless, transportation outlays are projected to rise at a slower rate than in the past--4.6 percent a year, compared with a past annual rate of about 10.5 percent. Expenditures for highway and maritime activities increase the fastest, while outlays for rail programs fall below their 1982 levels (see footnote 2).

The commerce and housing credit function accounts for most of the remaining projected growth--about $1.42 billion by 1987. Outlays in this function are projected to grow at a slightly slower rate than in the past--about 5.5 percent annually, compared to about 7.5 percent in the past--with virtually all of this growth occurring in the housing credit programs.

Community and regional development programs are projected to see little outlay growth over the next five years, since current expenditure levels include a large balance of previously appropriated funds that are projected to spend out in the near term. Annual outlays for this function are projected to grow by less than 1 percent, compared with historical yearly rates of about

12.5 percent. Baseline outlays for area and regional development actually decline from 1982 levels, falling by about $450 million by 1987.

BUDGET STRATEGIES

Federal expenditures for transportation and regional development could be reduced through a variety of strategies. Although very large budget reductions would ultimately require a restructuring of federal roles and priorities, significant reductions could nonetheless be achieved within the current governmental framework. These reduction strategies include:

- Increasing user fees;
- Shifting responsibilities to state and local governments;
- Targeting funds to the neediest areas and populations; and
- Reducing subsidies for private-sector activities.

Increasing User Fees

A large portion of federal expenditures for transportation and development is currently funded through user fees. The justification for user fees rests in the fact that, though many federal activities under these budget functions could not efficiently be provided by the private market, they yield significant benefits to specific classes of users, many of whom have the ability to pay. These beneficiaries can be identified and charged for the costs incurred by the government (producing revenues or offsetting receipts), thereby promoting efficient allocation of resources. 3/ Federal intervention is simply necessary to coordinate, rather than subsidize, these activities. In many cases, however, the current user fees do not recover the full costs of specific goods or services, and in some instances, no user fees at all are now imposed. Such undercharges distort the allocation of resources among competing purposes.

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3. Most of the specific options discussed in this chapter would increase revenues. Some, however, would be reflected in reduced outlays since they are offsetting receipts. Either way, the budget deficit is reduced.

Existing User Fees. The largest user charges now in effect are those levied against transportation users. In 1981, the revenues from user charges recovered almost half of the $23.3 billion in federal expenditures for the transportation budget function (see footnote 1). Reliance on user fees varies considerably among individual transportation modes, however.

The primary transportation user charges are those that finance the highway and airway programs. Highway user charges (a series of excise taxes on gasoline, diesel fuel, oil, tires, and trucks and truck parts) are earmarked and set aside in the Highway Trust Fund for use only in highway programs. This mechanism is intended to make the federal highway program self-supporting: beneficiaries are charged for what they receive. Similarly, the Airport and Airway Trust Fund, established in 1970 to fund federal expenditures for airports and airways, is financed through passenger ticket taxes and certain other taxes paid by airport and airway users. The user-financing mechanism was also recently extended to inland waterways. Inland waterway user charges, in the form of a fuel tax, took effect in 1981 and will be phased in over the next five years, rising from 4 cents per gallon at the outset to 10 cents per gallon in 1986 and thereafter.

Although user charges contribute significantly to the federal effort in highways, airways, and to a lesser extent, waterways, current revenues fall short of specific program costs. About 96 percent of federal highway spending in 1981 was financed through user fees paid into the Highway Trust Fund. 4/ Similarly, user fees funded about 42 percent of all federal expenditures for airway capital and operating costs; the Airport and Airways Trust Fund financed only about 23 percent of the airway system's operating costs in 1981, despite a trust fund surplus of about $3 billion. Inland waterway user charges funded less than 5 percent of 1981 expenditures and, although increases in these charges are planned, they are projected to fund only about 9 percent of federal inland waterway expenditures in 1987.

Federal deficits could be reduced by extending current financing mechanisms to shift to users more of the federal costs for highways, airways, and inland waterways. Full recovery of all

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4. This estimate only accounts for highway expenditures under budget function 400 (transportation). Additional highway expenditures--included under other budget functions and funded from general funds--totaled more than $1.0 billion in 1981.

federal costs for highways (including highway expenditures outside the transportation budget function), airways, and inland waterways would reduce net federal expenditures (federal outlays less revenues from users) by about $3.5 billion in 1983--$1.5 billion for highways, $730 million for inland waterways, and $1.3 billion for airways (see Appendix B-300-c and A-400-e). Moreover, as the costs borne by users increase, some reduction in total federal outlays may be realized, as beneficiaries of the various services respond to the increased costs by lowering demand.

Increasing user charges raises questions regarding the proper allocation of costs and tax receipts among the various subsidiary modes. For example, general aviation (mainly planes owned by firms and individuals for their own business and personal use) has historically paid only a small proportion--less than 15 percent--of its share of federal aviation expenditures, while commercial air carriers, through ticket taxes and other fees, have generally paid most of their attributable costs. Increased user fees for air transportation could therefore be accompanied by a shift in the cost burden to general aviation (see Appendix B-400--a). Similarly, although conclusive findings are not yet available, the heaviest classes of trucks do not appear to pay their full share of federal highway costs. Although federal highway expenditures are largely offset by user fees, a restructuring of highway user fees to reflect more nearly the costs occasioned by various classes of highway users would be more equitable, and it would also promote a more efficient transportation network.

New User Fees. The user-charge principle could also be extended to other federally funded transportation activities, specifically maritime activities carried out by the U.S. Army Corps of Engineers and the Coast Guard. The Corps of Engineers spends about $500 million each year to improve and maintain ports and channels to accommodate oceangoing vessels. In addition, the Coast Guard spends more than $1 billion annually on activities that benefit commercial and recreational boaters. These activities include navigational aids for commercial shipping, search-and-rescue operations for private mariners (mostly recreational boaters) who are lost or otherwise in trouble, and marine safety.

As with other modes of transportation, the cost of the activities listed could be recovered, at least in part, directly from the beneficiaries--specifically, the commercial shipping industry and recreational boaters (see Appendix B-300-d and B-400-b). Though these activities have traditionally been subsidized by the federal government, there is no inherent reason why the user-

charge principle could not be extended to encompass these functions. For example, with 1.4 million large recreational boats berthed in coastal areas and more than 10 million recreational boats in inland waters, a modest annual (registration) fee could be assessed to recover the search-and-rescue costs attributable to recreational boaters. Full recovery of the allocable federal costs for these navigation and recreational boating activities would reduce net federal expenditures by about $1.2 billion in 1983 and might result in some reduction in total federal outlays as users responded to the increased costs by lowering demand for services.

The primary arguments against imposing user charges for navigation and search-and-rescue activities include the difficulty in establishing fair cost allocations among the various kinds of users, the administrative problems in collecting a new set of fees, and the potential reductions in shipping and boating activities resulting from increased user costs. Given the very small cost increases (relative to total current user costs) implied by these fees, however, such effects would be minor. Moreover, potential disruptive impacts could be minimized by phasing in the implementation of these fees.

The user-charge principle could also be extended to a variety of activities in the commerce area. At present, user charges are levied for a number of services performed or information provided by the Department of Commerce, including economic and statistical data in the areas of commerce, trade, and science. User-charge receipts for these activities could be increased by as much as $50 million, however, if fees were extended or increased to recover all appropriately assignable costs. In addition, the Monetary Policy Control Act of 1980 established user fees for various services of the Federal Reserve Bank, including check collection, electronic funds transfer, and coin wrapping. These charges yielded around $150 million in 1981 (calendar year) and will grow in 1982 and thereafter as other provisions of the act are phased in. Similar user charges could be extended to services provided by the Federal Communications Commission (FCC), the Securities and Exchange Commission (SEC), and the Commodity Futures Trading Commission (CFTC). For example, authorizing legislation now pending in the House (H.R. 3239) and the Senate (S. 821) would establish fees for the FCC that would result in an additional $30 million in annual receipts to the federal government. Altogether, increased user charges in the commerce area could yield upwards of $100 million a year in new federal receipts after 1982.

In sum, the increases in user fees discussed above could reduce net federal expenditures by more than $4.8 billion annually. Full recovery of total federal costs for highways, airways, and inland waterways could reduce net federal expenditures by about $3.5 billion in 1983. Extending the user-charge principle to the deep-draft navigation and recreational boating activities carried out by the Army Corps of Engineers and the Coast Guard could reduce net federal expenditures by an additional $1.2 billion annually. Additional receipts of roughly $100 million could probably be realized by additional user charges for services provided by the Commerce department, the FCC, the SEC, and the CFTC.

Shifting Responsibility to State and Local Governments

Federal programs for transportation and development extend large amounts of federal aid to state and local governments. In 1981, such federal aid reached about $19 billion, or 52 percent of total federal transportation and development expenditures. Thus, one strategy for reducing the federal budget would be to reduce local aid, shifting ultimate financial responsibility for various activities, particularly transportation, to lower levels of government.

The justification for such a transfer of financial responsibilities is that many of the activities funded convey very localized benefits and that such activities are more appropriately funded by the particular beneficiaries--the localities--rather than by the general taxpayer. Furthermore, many of the activities that now receive federal support might be more efficiently funded and carried out at the local level. State and local officials in general are most aware of local conditions and needs. Moreover, federal support for various activities has probably resulted in some perverse incentives to states and localities (discussed below). Shifting financial responsibilities to state and local government therefore might result in more efficient allocation of scarce resources.

One way to curtail federal financial responsibility would be to restrict federal aid to programs or projects that are truly national in scope. For example, federal highway aid could be limited to routes that primarily serve interstate travel; federal support for essentially local highway systems or segments could be terminated. The National System of Interstate and Defense Highways now includes many urban segments that carry little other than local traffic. Moreover, federal funds are provided for secondary

and urban roads that are not part of the Interstate Highway System and that are serving local needs. The Interstate Highway System could be redefined to include those projects that serve truly interstate commerce and passenger travel, resulting in an estimated five-year savings of about $9 billion in outlays (see Appendix A-400-d). Morever, terminating federal aid for secondary and urban roads could reduce outlays by an additional $5 billion over the next five years. Thus, leaving financial responsibility for local routes to the state and local governments could result in significant federal savings over the next five years--$25.7 billion in budget authority and $14.3 billion in outlays.

Similarly, substantial savings could be realized by terminating all capital aid for local mass transit systems--about $7 billion in outlays over the next five years--and discontinuing mass transit operating subsidies for annual outlay savings of about $1 billion (see Appendix A-400-b and A-400-c). Likewise, grants-in-aid for large airports could be terminated, resulting in a five-year outlay savings of about $800 million (see Appendix A-400-f).

Despite federal budget savings and potential improvements in resource allocation, however, sudden elimination of all federal aid for various state and local activities might be an undesirable course of action. Financial burdens on state and local governments would increase, and many services or activities would probably be cut or sharply curtailed. Moreover, federal assistance may serve another important function--to ensure an equitable distribution of resources among localities and populations that have varying fiscal capacities to support local services. Terminating all state and local aid would therefore have adverse equity effects.

Maintaining federal support for various local activities at lower funding levels (with the potential long-term goal of phasing out all federal aid) could lessen the disruptions and hardships felt by state and local governments. For example, one alternative to eliminating all capital grants for mass transit would be to lower the federal matching ratio from its current level (see Appendix A-400-c). At present, the federal government distributes $2.5 billion a year to urban areas for mass transit capital grants on an 80-to-20 federal-to-local matching basis. This high federal matching ratio creates an incentive for states and localities to over-invest in capital facilities, and it may promote premature, hence uneconomical, retirement of capital stock. Lowering the federal match from 80 to 50 percent would result in significant budgetary savings--about $2.9 billion in outlays over the next

five years--while limiting disruptions to state and local governments and reducing perverse investment incentives. Similarly, additional savings could be realized by scaling back (instead of entirely eliminating) federal expenditures for other local activities, such as transit operating subsidies, aid for local highways and streets, and grants-in-aid for large airports.

Alternatively, reductions in federal funding support for state and local activities might be achieved by consolidating assorted categorical grant programs into a large block grant or revenue sharing program (discussed elsewhere in this report). For example, a number of capital grants that are used to maintain, replace, and develop local infrastructure (such as grants for highways, mass transit, and sewage facilities) could be consolidated into one large grant for public construction. This approach would enhance local flexibility in allocating funds and could thereby promote efficient allocation of resources. Moreover, the federal objective of promoting an equitable distribution of resources among localities could be maintained. At the same time, however, it should be noted that consolidating grants can at times diminish the degree to which recipient states and localities use their grant monies to pursue national policy objectives.

Targeting Funds to the Neediest Areas and Populations

Federal transportation and development programs now benefit a variety of recipients. Targeting federal expenditures to those areas, populations, or beneficiaries with the greatest need or benefit potential could result in significant budgetary savings while enhancing the cost effectiveness of federal expenditures.

This reduction strategy is particularly applicable in the area of community and regional development, in which the effectiveness of federal expenditures depends on the federal government's ability to direct funds to areas and populations with serious economic and social problems and to assist only those undertakings that could not otherwise be funded. In this regard, substantial savings could be realized by targeting federal community and regional development programs on the neediest populations or communities. An example would be a tightening of the now quite loosely restricted Community Development Block Grant (CDBG) program--itself an example of grant consolidation dating back to 1974--which will disburse some $3.5 billion in federal funds in 1982. (The CDBG program replaced an assortment of categorical development programs, including the Urban Renewal and Model Cities